

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



November 16, 2004

Agenda ID 4081
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 04-03-021

This is the draft decision of Administrative Law Judge (ALJ) Walwyn. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKEN

Angela K. Minken, Chief
Administrative Law Judge

ANG:hl2

Attachment

Decision **DRAFT DECISION OF ALJ WALWYN** (Mailed 11/16/2004)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Pacific Gas and Electric Company
Proposing Cost of Service and Rates for Gas
Transmission and Storage Services for 2005 and
Backbone Level Service and Rates Starting
January 1, 2005, as Required by Commission
Decision 03-12-061.

Application 04-03-021
(Filed March 19, 2004)

OPINION ADOPTING GAS ACCORD III SETTLEMENT**I. Summary**

This decision adopts a comprehensive settlement and associated tariff changes that continue the basic Gas Accord market structure for Pacific Gas and Electric Company's (PG&E) storage and transmission services for a three-year term commencing January 1, 2005. The settlement, titled the "Gas Accord III Settlement Agreement" (Gas Accord III), settles all issues in this proceeding and also supersedes and extinguishes PG&E's obligation under Ordering Paragraph 6.j of Decision (D.) 03-12-061 to file a new application by February 2005 addressing rates and market structure for 2006 and beyond.¹

¹ The Gas Accord market structure and rates for PG&E were originally approved in the Gas Accord Settlement Agreement that was adopted in D.97-08-055 (73 CPUC2d 754) and implemented on March 1, 1998. That settlement, and the time period covered by the settlement (through December 31, 2002), is commonly referred to as the "Gas Accord." On October 8, 2001, PG&E filed Application (A.) 01-10-011 requesting that the Gas Accord structure and rates for its gas transmission and storage system be extended

A motion for approval of the Gas Accord III settlement agreement (Joint Motion) was filed on August 27, 2004 by PG&E and a broad array of parties representing every affected segment of the natural gas industry (The Settlement Parties).² All active parties in this proceeding are included in the Settlement Parties and no protest or comments on the settlement were received.

The major contested issues resolved by the Gas Accord III are:

(1) adoption of eligibility standards and cost allocation methodology for a backbone-level end-use service; (2) increased access to PG&E's backbone transmission system for Core Transport Agents (CTAs) and independent storage providers; (3) agreement on a procedural process to address whether incremental gas storage needs for the core should be put out to bid; (4) 2005 through 2007 backbone load factors; and (5) a phase-in of the "direct assignment" method of cost allocation.

for two more years (through the end of 2004) pending the resolution of PG&E's bankruptcy filing. In D.02-08-070, we approved a settlement by the parties to extend the Gas Accord until December 31, 2003 (Gas Accord II), and in D.03-12-061 we issued a decision resolving the issues for the period January 1, 2004 through December 31, 2004 in a manner very similar to what was contained in the Gas Accord.

² The Settlement Parties are as follows: PG&E, ABAG Publicly Owned Energy Resources, the California Cogeneration Council, the California Manufacturers and Technology Association, Calpine Corporation (Calpine), the Canadian Association of Petroleum Producers, the City of Coalinga, Coral Energy Resources, LP, Duke Energy North America, LLC, and Duke Energy Marketing America, LLC (collectively, "Duke"), GTN, Indicated Producers (representing Chevron U.S.A. Inc, Occidental Energy Marketing, Inc., Valero Refining Company - California, BP Energy Company, and ConocoPhillips Company), Lodi Gas Storage, L.L.C. (Lodi), Mirant Americas, Inc. (Mirant), the Northern California Generation Coalition (NGCC) (representing Silicon Valley Power, Turlock Irrigation District, Modesto Irrigation District, Northern California Power Agency, and City of Redding), the Office of Ratepayer Advocates (ORA), the City of Palo Alto, Sacramento Municipal Utility District, the School Project for Utility Rate Reduction, JPA, the State of California Department of General Services, TURN, and Wild Goose Storage, Inc. (Wild Goose).

The Gas Accord III does not settle all issues concerning gas rates paid by PG&E customers. Distribution level service rates, gas commodity costs, and some aspects of customer class charges are set in other proceedings.

II. Procedural Background

On March 19, 2004, PG&E filed this application proposing rates effective January 1, 2005 for gas transmission and storage services, to include a new rate category for a backbone-level end-use service, as required by D.03-12-061. On May 11, 2004 a prehearing conference was held to discuss areas of dispute raised in written protests and to set a procedural schedule for evidentiary hearings.

The assigned Commissioner's and administrative law judge's (ALJ) Ruling and Scoping Memo, issued May 22, 2004, narrowed the scope of PG&E's original application and supporting testimony, emphasizing that consistent with the direction provided in D.03-12-061, this proceeding was on an expedited schedule and had a limited scope. This ruling was reaffirmed in a July 6, 2004 ruling on PG&E's request for reconsideration of two issues and NGCC's motion to strike testimony.

ORA served its Report on Operations on June 25, 2004. Interested parties served opening testimony on July 6, 2004 and all parties served concurrent rebuttal testimony on July 16, 2004. While preparing for hearings, parties also participated in several settlement negotiations.

On the eve of scheduled evidentiary hearings, parties represented that a settlement had been reached and e-mailed the ALJ and parties the terms of the settlement. At a second prehearing conference on August 2, 2004, a procedural schedule was set that included another formal settlement conference, the filing of a motion for settlement approval, and an opportunity for comment and reply comment. The motion for approval of the settlement, together with the Gas

Accord III, pro forma tariffs, and supporting documents, was filed on August 27, 2004.

III. The Gas Accord III Settlement

a. Overview

The Gas Accord III is attached to this decision as Attachment A. In the motion for approval of the Settlement, the Settlement Parties also included: (a) a description and discussion of the settlement terms; (b) a comparison matrix of the parties' litigation positions; (c) additional tables showing results of operations, cost of service allocations and illustrative rates for the Baja Path and Redwood Path backbone service; (d) pro forma tariffs showing all tariff changes needed to implement the Gas Accord III; and (e) cost allocation and rate design workpapers.

The Gas Accord III explicitly preserves the fundamental market structure, rules and features of the original Gas Accord, as modified by subsequent Commission decisions, and retains this structure in place for three years.³ In their motion for approval, the Settlement Parties state that the settlement makes six minor changes to the earlier Gas Accords. These changes, each of which is discussed in the following sections, consist of: (1) backbone level end-use service; (2) storage-related changes; (3) balancing account treatment for core local transmission service; (4) a phase-in of the direct assignment method of cost allocation; (5) services for Core Transportation Agents; and (6) elimination of the commensurate discount rule.

³ Certain provisions of the Gas Accord were modified by D.00-02-050, D.00-05-049, and D.03-12-061.

The Gas Accord III goes beyond the 2005 rate case scope of this proceeding by addressing gas market structure and rate issues for 2006 and 2007. Written notice of the proposed settlement was given to all parties in PG&E's last gas market structure case because the terms of Gas Accord III would supersede and extinguish PG&E's requirement under D.03-12-061 to file an application by February 4, 2005 proposing rates and a gas market structure for the period commencing January 1, 2006.

The Settlement Parties state that the longer time frame provided under the settlement provides for a protracted period of rate certainty as well as a stable business environment for the natural gas industry in Northern California.

b. The Settlement's Key Provisions

The Gas Accord III has seven sections. Following is a discussion of the key provisions of each section.

(1) Introduction

The introductory section states that the purpose of Gas Accord III is to resolve all the issues set for litigation in this proceeding and to supersede and fulfill D.03-12-061's requirement to file an application by February 4, 2005 addressing market structure and rates for PG&E's gas transmission and storage system beginning in 2006. The parties request that the Commission approve the pro forma tariff sheets at the same time we approve the settlement agreement, and that the tariffs and rates be effective on January 1, 2005.⁴

⁴ The section also states that Gas Accord III is to be treated as a complete package, not as a collection of separate agreements on discrete issues or proceedings, and in the event the Commission rejects or modifies the settlement agreement, the parties reserve their rights under Rule 51.7 of the Commission's Rules of Practice and Procedure.

(2) Terms of Settlement

The Settlement Period is from January 1, 2005 through December 31, 2007 for transmission services and April 1, 2005 through March 31, 2008, for storage services. PG&E commits to file its next rate case no later than February 9, 2007. The settlement also provides that should new rates not be in place by January 1, 2008, the interim transmission and storage rates will equal the rates in effect on December 31, 2007 plus a two percent escalator. According to the settlement, these interim rates will remain in effect until the Commission otherwise approves rates for the remainder of 2008.⁵

(3) Transmission Services

This section addresses both transmission and storage issues. The key change from Gas Accord II is the establishment of a new backbone level end-use service and the cost allocation treatment provided to other customers. This section adopts PG&E's originally proposed eligibility criteria for backbone level end-use service and balancing account treatment for changes in local transmission demand arising from customers taking the new service.⁶ In addition, it provides Duke a \$2 million per year bill credit on its local transmission level service to its gas-fired power plants at Moss Landing Units 1 and 2, to be collected through PG&E's backbone rates as a volumetric surcharge.

⁵ The settlement does not apply the rate escalators to G-XF (contracts for Redwood Path capacity that were signed when Line 401 was built). The rates for these contracts were set in D.03-12-061 for 2004 based on the incremental Line 401 pipeline expansion project cost of service.

⁶ Even though backbone level end-use customers will not contribute towards PG&E's local transmission cost-of-service, these customers still will be obligated to pay applicable public purpose program and related end-use surcharges.

This section also provides that the commensurate discount rule will be removed from PG&E's tariffs once PG&E is no longer affiliated with Gas Transmission Northwest (GTN), the former Pacific Gas Transmission Company.

For storage, independent storage providers were not in operation at the time the Gas Accord was approved and implemented. To accommodate the interests of independent storage providers, Gas Accord III provides that PG&E will change its off-system Mission tariff to allow storage withdrawals to flow off-system at a zero rate. PG&E will also modify its backbone transportation tariffs to allow storage as a receipt point for firm backbone contracts.

(4) Storage Services

This section provides that there will be no open season for noncore storage services at the outset of Gas Accord III because PG&E currently has sufficient firm storage capacity available for sale.⁷ The language in this section also affirms the assignments of firm storage to pipeline balancing remain as approved in D.03-12-061 and confirms PG&E's right to file an application under Section 851 to sell some of its noncycle working gas.

(5) Cost of Service

This section, along with the accompanying tables, details the cost of service upon which the Gas Accord III rates are based.⁸ The settlement contains several downward adjustments, as proposed in testimony by the Office of Ratepayer

⁷ If circumstances change during the Settlement Period, PG&E should file by Advice Letter a request to hold an open season, setting forth the proposed terms and conditions of the offering.

⁸ A clerical error appears in Section 5.3; the revenue requirement table shown there should state that the numbers are in millions of dollars.

Advocates and other parties. The total revenue requirement escalates at two percent for 2006 and 2007, except for the revenue requirement attributable to the G-XF contracts and other adjustments authorized by the settlement.⁹

A key provision of this section is that operating expenses after January 1, 2006 will be allocated based on a new method, referred to as a direct assignment method. The direct assignment method will result in an allocation of greater costs to the backbone transmission function, and a corresponding decrease in the allocation of costs to the local transmission function.¹⁰

(6) Cost Allocation and Rates

This section confirms that the Gas Accord structure and rate design is unchanged under Gas Accord III. The key provision is the agreed-upon load factors for the three years. The Settlement Parties state these figures represent a negotiated compromise of the litigation positions put forth by various parties and the load factor negotiation included consideration of many other aspects of the Settlement, including the starting cost of service and the cost escalation rate for 2006 and 2007. In the Joint Motion, the Settlement Parties assert that the negotiated load factors are actually higher than the adjusted load factor of 70.91% shown in PG&E's revised testimony in this case and, further, the

⁹ For comparison, the Gas Accord provided for a 2.5%/year escalation for 1998 through 2002. The settlement adopted in D.02-08-070 for 2003 Gas Accord rates provided for no rate escalation and D.03-12-061 adopted rates for 2004 based upon a new revenue requirement and not a mechanical escalation rate. In addition, the recently approved settlement of PG&E's general rate case (A.02-11-017) provides attrition increases for 2006 for the distribution (range of 3-4%) and generation (range 2.5-4%) systems.

¹⁰ This is a phase-in. For 2005, the allocation is based 50% on the old methodology and 50% on the direct assignment method.

negotiated load factors also equal or exceed the 74.05% load factor proposed by The Utility Reform Network (TURN).¹¹

Provisions in this section also provide for balancing account treatment for the revenue requirement associated with local transmission service to PG&E's core gas customers. This is a change from the Gas Accord and is done to reduce the year-to-year variability of this cost component.

(7) PG&E Core Procurement and Core Transportation Agents

In this section, PG&E commits to file an application within a specified period to address how much, and by what process, incremental gas storage needs for the core should be put out to bid as well as other implementation issues that PG&E feels need to be addressed before the provisioning of core storage is opened to independent storage providers. Further, PG&E agrees to meet with ORA, TURN, third-party storage providers and other parties to discuss, and attempt to reach a consensus on the contents of such a filing.

The remaining provisions in this section pertain to service by CTAs who compete with PG&E's Core Procurement Department for gas commodity service to PG&E's core customers. The provisions provide new access for CTAs to pipeline capacity from Canada and raise the Core Brokerage fee from \$0.024 per Decatherm (Dth) to \$0.030 per Dth.

(8) Rate Certainty and Adjustments During Term of Settlement

The key provision of this last section is that the cost of capital used to set rates for the Settlement Period will be the cost of capital for 2005 adopted by the

¹¹ PG&E's revised testimony was filed on July 14, 2004 in compliance with the scoping memo rulings of May 27, 2004, July 6, 2004, and July 9, 2004. PG&E's revised load factor includes a 95% at risk adjustment for Line 401 and removes an earlier filed "slack capacity adjustment."

Commission in A.04-05-023. The section also clarifies that certain rates, such as the Distribution and Customer Class charge, will continue to change with PG&E's Biennial Cost Allocation Proceeding or Annual True-Up filings, and as a result of other Commission decisions.

4. Discussion

a. Standard of Review for Settlements

We review this uncontested settlement pursuant to Rule 51.1(e) which provides that, prior to approval, the Commission must find a settlement "reasonable in light of the whole record, consistent with the law, and in the public interest."¹² We undertake our review by addressing each of these three elements.

b. Reasonable in Light of the Whole Record

The Commission has a comprehensive record upon which it can evaluate and approve the Gas Accord III. PG&E served its testimony on March 19, with revisions on June 11 and July 14, 2004. On June 29, 2004, ORA served its Report on the Results of Operations for PG&E's 2005 Gas Transmission and Storage rate case. A broad range of parties participated in discovery and served testimony

¹² The Settlement Parties filed Gas Accord III under Rule 51.1(e). The settlement has the support of all active parties in this proceeding and additional parties in A.01-10-011. Gas Accord III meets the lesser standard of review for all-party settlements adopted in D.92-12-019. The criteria established in D.92-12-019 require: (1) the unanimous sponsorship of all active parties to the instant proceeding; (2) that the sponsoring parties are fairly reflective of the affected interests; (3) that no term of the settlement contravenes statutory provisions or prior Commission decisions; and (4) that the settlement conveys to the Commission sufficient information to permit us to discharge our regulatory obligations with respect to the parties and their interests.

and rebuttal testimony.¹³ For the sole purpose of the Commission having the whole record available to evaluate the reasonableness of Gas Accord III, all served testimony is admitted as evidence under a separate ruling dated November 16, 2004.

The comparison matrix attached to the August 27, 2004 Joint Motion is comprehensive and cites to specific sections of numerous parties' opening and rebuttal testimony in its summary of litigation positions. A separate matrix column demonstrates that the resolution of each issue is within the range of litigation positions. On the most contested issues, compromises that we consider fair and reasonable are the outcome. In making this finding, we cite specifically to the issues of (1) backbone level end-use service definition with the trade-off billing credit to Duke, (2) negotiated load factors, (3) additional access to PG&E's backbone transmission system for CTAs and independent storage providers, and (4) the phase-in of the direct assignment method of cost allocation.

We also agree with the Settlement Parties that a three-year comprehensive settlement is preferable to having litigated a one-year rate case. In addition, we find it very persuasive in evaluating the reasonableness of the settlement that not only is it an all-party settlement, but that every segment of the natural gas industry is represented in the large list of Settlement Parties.

¹³ Active parties in A.04-03-021 are those parties that filed written protests and comments and/or served testimony. These parties are: PG&E, ORA, Calpine Corporation/the California Cogeneration Council, the Canadian Association of Petroleum Producers, the City of Palo Alto, Duke Energy North America, LLC/Duke Energy Marketing America, LLC, the Indicated Producers ad hoc coalition, Lodi, Mirant, Northern California Generation Coalition, the Sacramento Municipal Utility District, TURN, and Wild Goose.

The issues covered in the Gas Accord III address all contested issues in this proceeding and also go beyond the scope of this case to include 2006 and 2007 market structure and rates. PG&E noticed all the parties to its last market structure case (A.01-10-011) that its proposed settlement would cover a broader range of issues than originally raised in the application and that the proposed settlement would supersede and extinguish D.03-12-061's requirement for a 2006 market structure proceeding. Based on this notice, additional parties such as the CTAs actively participated in the noticed settlement conferences.

The parties reached agreement on the eve of evidentiary hearings and asked that the hearings be cancelled. We find that there is a comprehensive record available to evaluate the settlement and we find that there is no issue that requires any additional record.

Based on the above discussion, we find the Gas Accord III is reasonable in light of the whole record.

c. Consistent With the Law

(1) Adequacy of Notice

The legal issue of notice arises from the settlement covering more issues that were originally raised in the application. Because of the expanded scope of the proposed settlement, PG&E provided notice and an opportunity to participate to all parties in A.01-10-011 and we should likewise do so here by noticing the parties of both proceedings of our draft decision. Specifically, the Gas Accord III will supersede and extinguish PG&E's obligation under Ordering Paragraph 6.j of D.03-12-061 to file a new application addressing rates and market structure for 2006 and beyond.

A question also arises as to whether the written notice that PG&E initially provided the public at the outset of this one-year case gave potentially interested

persons sufficient notice that PG&E's application might result in a settlement covering a longer, three-year rate period. The notice that PG&E sent to its customers in their monthly bills states that "when the Commission acts on this Application, it may adopt all or part of PG&E's request, amend or modify it, or deny the Application." Given that this is an all-party uncontested settlement and that the Settlement Parties represent every affected segment of the natural gas industry, we find that the written notice that PG&E has provided to its customers is sufficient notice. Our finding here is consistent with our approval in D.04-05-055 of a settlement of PG&E's General Rate case.¹⁴

(2) Bill Credit for Unit 1 and 2 at the Moss Landing Power Plant

Section 3.3.1 of the Settlement Agreement provides that, for the three-year term of the Settlement, Units 1 and 2 at the Moss Landing Power Plant will receive a monthly bill credit amounting to \$2.0 million annually. Service to other units at the Moss Landing plant will be provided at the otherwise applicable local transmission rate that results from this settlement. Units 1 and 2 are new, combined-cycle units installed at the existing plant site that came on line in 2002. Units 1 and 2 would not qualify for the backbone level rate under the criteria PG&E proposed in its testimony in this case, because they have been served by existing PG&E local transmission lines.

This provision of the Settlement Agreement is reasonable in light of the litigation positions taken by the parties in this case and is legally supportable because the Commission has long recognized that it is appropriate for utilities in

¹⁴ The GRC settlement adopted in D.04-05-055 sets rates for 2003 with attrition in the years 2004, 2005, and 2006. PG&E's original application sought attrition only through 2005.

certain circumstances to offer special arrangements, such as rate discounts, to certain customers if that action benefits all of the utility's other customers.

Duke submitted testimony in this case that included proposed eligibility criteria for the backbone level end-use service favoring the development of new generating units on brownfield sites (the sites of existing generating plants), including units - such as Moss Landing Units 1 and 2 - that have been served by existing PG&E local transmission lines. Under Duke's proposed criteria, some additional generating units might have been eligible for backbone-level service beyond those that would have been eligible under PG&E's proposed eligibility criteria. In response to Duke's application for rehearing of D.03-12-061, moreover, the Commission in D.04-05-061 granted Duke's request for an opportunity to be heard with respect to these broader criteria. (D.04-05-061, *mimeo*, pp. 21 and 25 (new Conclusion of Law 108).) PG&E's testimony, in turn, asserted that, under Duke's proposed approach, the remaining customers on PG&E's local transmission system (including PG&E's core customers) would have experienced greater cost-shifting and potentially higher local transmission rates than under PG&E's eligibility proposal.

The Moss Landing plant currently is the largest single customer served by the PG&E local transmission system, contributing in excess of \$5 million per year towards the local transmission revenue requirement. Had this case proceeded through full litigation, PG&E's other local transmission customers would have faced the litigation risk that the Moss Landing plant would have qualified for the backbone level end-use rate option.

The Settlement strikes a compromise between the various litigation positions and avoids the prospect of additional cost-shifting to local transmission customers, by adopting PG&E's proposed eligibility criteria for the backbone

level rate option. In return for Duke's agreement to join in the Settlement Agreement, and accept PG&E's proposed eligibility criteria, it is reasonable to provide a bill credit for service to Units 1 and 2 at the Moss Landing generating plant for the three-year term of the Settlement.

(3) Unspecified Provisions of the Settlement

Based on our review of the settlement, we find there is a need to clarify and specify the non-Gas Accord provisions of D.03-12-061 that are being extended under the Gas Accord III. In D.03-12-061, the Commission adopted a number of provisions that were not a part of the existing Gas Accord, and provided that these provisions would expire at the end of 2005. Our interpretation of Section 1.2 of the settlement is that these provisions would be extended for the life of Gas Accord III. The part of Section 1.2 that addresses this is:

This Settlement Agreement makes certain small modifications to the existing Gas Accord provisions, as most recently modified in D.03-12-061, in addition to implementing a backbone level end-use service as ordered in D.03-012-061.

We find this single reference to be cryptic and as there is not an explicit discussion of this in the motion for approval of the settlement or its accompanying documents, we interpret the details here. By so doing, the Settlement Parties will an opportunity to correct our interpretation, if necessary, in the comment cycle on the draft decision.

Ordering Paragraph 1 of Decision (D.) 03-12-061 provided in broad, general language for an extension of the entire Gas Accord market structure. It stated:

1. The existing gas market structure contained in Decision (D.) 97-08-055, as modified by D.00-02-050 and D.00-05-049,

and as changed by the proposals adopted in today's decision, shall serve as the gas market structure for the gas transmission and storage facilities and operations of Pacific Gas and Electric Company (PG&E) for 2004 and 2005.

- a. The proposals adopted today, as set forth in the Conclusions of Law and as described and discussed in this decision, shall be incorporated into the gas market structure.
- b. PG&E shall conduct its transmission and storage operations in accordance with the adopted gas market structure, and with all other applicable rules, regulations, and Commission decisions.

(D.03-12-061, p. 461.)

In addition to this general extension of the Gas Accord market structure, the Commission in D.03-12-061 also culled out particular components of the existing market structure, and expressly extended them through 2005. The most important of these individually-mentioned items included: (i) the "z factor" adjustment from the original Gas Accord; (ii) the Catastrophic Events Memorandum Account (CEMA) and the Hazardous Substance Mechanism (HSM); (iii) the Core Procurement Incentive Mechanism (CPIM); and (iv) the Risk Management Program and authority to use financial derivatives. (See D.03-12-061, Conclusion of Law 80 (z factor adjustment); Conclusion of Law 81 (CEMA and HSM); Conclusion of Law 86 (CPIM); and Conclusions of Law 101 and 102 (Risk Management Program and authority to use financial derivatives, respectively).) In addition to being separately mentioned in the Conclusions of Law, each of these items also was discussed individually in the body of the decision itself. (See D.03-12-061, pp. 381-382 (z factor adjustment, and CEMA

and HSM); p.395 (CPIM); and pp. 435-436 (Risk Management Program, and authority to use financial derivatives).)

The Commission in D.03-12-061 also provided for: (i) continuation of an existing cash out mechanism for imbalances (D.03-12-061, pp. 180-181, and Conclusion of Law 23); (ii) continuation of PG&E's existing process for local curtailments (id., p. 185, and Conclusion of Law 33), and approval of local curtailment charges (id., p. 185, and Conclusion of Law 34); and (iii) continuation of a customer self balancing option (id., p. 295, and Conclusion of Law 61).

The Gas Accord III Settlement Agreement, dated August 27, 2004, adopts essentially the same approach used by the Commission in D.03-12-061. By the use of broad, general language, the Settlement proposes to extend the entire Gas Accord market structure through 2007, subject to the various modifications specified in the Settlement document itself. Thus, Section 1.2 provides that the Gas Accord, as approved in D.97-08-055 and modified thereafter, including the modifications adopted in D.03-12-061, will be extended for the three-year term of the Gas Accord III Settlement. Importantly, moreover, Section 1.5 of the Settlement Agreement provides for the continuation of all existing, approved tariff provisions pertaining to the PG&E gas transmission and storage system, except to the extent those tariffs are expressly amended by the Gas Accord III Settlement. The specific requested tariff language changes (with the exception of the final rate numbers) were filed with the Settlement Agreement itself, for approval by the Commission. (Settlement Filing, Tab 5.)

The Gas Accord III does not individually address the extensions of the z factor adjustment, CEMA and HSM, CPIM, or Risk Management Program and financial derivatives authorization. Likewise, Gas Accord III does not expressly mention continuation of the cash out mechanism for imbalances, the local

curtailment process and associated curtailment charges, or continuation of the customer self-balancing option. Rather, the settlement appears to assume that continuation of all of these various adjustments and programs, as approved in D.03-12-061, through 2007 is intended by Section 1.2.

To ensure that interested parties and the general public understand exactly what action the Commission is taking, we state here our interpretation of Section 1.2 is that Gas Accord III extends the z factor adjustment, CEMA and HSM, CPIM, the Risk Management Program and financial derivatives authorization provisions approved in D.03-12-061. Consistent with this, we find that under Gas Accord III the tariff provisions remain for the cash-out mechanism for imbalances, the local curtailment process and associated curtailment charges, and the customer self-balancing option.

d. In the Public Interest

As shown in the comparison matrix and discussed above, the Gas Accord III is a reasonable compromise of the Settlement Parties' respective positions on individual issues and taken as a whole is fair and reasonable. There is a sound record basis for our findings and a broad array of active parties representing every segment of natural gas industry for Northern California joined in the settlement. We find that no term of the settlement contravenes statutory provisions or prior Commission decisions.

By continuing the previously-approved Gas Accord market structure, Gas Accord III will keep in place a gas market structure that has worked well in northern California over the past six years, including during the energy crisis period of 2000-2001.

The parties have avoided considerable litigation costs and uncertainty by entering a settlement and it has benefited the Commission by facilitating and

expediting our review and approval of rates and pro forma tariffs. Further, the three-year term of the Gas Accord III has the advantage of providing rate certainty as well as a stable business environment for the natural gas industry in northern California over a protracted period.

We find the Gas Accord III to be in the public interest.

e. Review of Pro forma Tariffs and Supporting Documents Attached to the Motion for Approval of Gas Accord III

Attached to the motion for approval are pro forma tariff sheets showing the tariff changes necessary to implement Gas Accord III. The sheets are highlighted to illustrate proposed text to be added or deleted to existing tariff sheets and address tariff language pertinent to balancing accounts, service agreements, rules, and rate schedules. We have reviewed the pro forma tariff sheets and find them to include tariff language that is consistent with the Gas Accord III and that covers all tariff changes needed to implement the settlement.

Based on our review of the supporting documents, we find that it would be beneficial for the Settlement Parties to provide the same level of detail on revenue requirement and results of operation that the Commission included in D.03-12-061. This can be done by having PG&E update Table 6-2 in its opening testimony to reflect the provisions of Gas Accord III and filing this new table with its compliance filing. PG&E should also include in the compliance filing a completed page 24 to the workpapers (Tab 6) that corrects the omission of line number 33; the missing information of this line is an integral part of the workpaper calculations used in the development of rates.

In summary, we approve the Gas Accord III settlement agreement, attached to this decision at Appendix A, and the pro forma tariffs filed on August 27, 2004, with the clarification language and table discussed here,

effective on January 1, 2005. Within 12 days of this decision, PG&E shall make a compliance filing to implement the rates and tariff provisions of Gas Accord III.¹⁵

5. Change in Determination on Need for Hearings

The May 27, 2004 scoping memo confirmed the categorization of this proceeding as rate-setting and determined that evidentiary hearings were required. As discussed here, the Gas Accord III contains sufficient information to adopt in its entirety and no issues remain for evidentiary hearing. Therefore, the determination that hearings are necessary is changed.

6. Comments on Draft Decision

The draft decision of the Administrative Law Judge in this matter was mailed to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

7. Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Christine M. Walwyn is the assigned ALJ in this proceeding.

Findings of Fact

1. On August 27, 2004, PG&E, on behalf of the Settlement Parties, filed a Joint Motion for Approval of “Gas Accord III” Settlement.
2. The Joint Motion contains the settlement, a list of Settlement Parties, a comparison matrix, additional tables showing Results of Operations, Cost of

¹⁵ The compliance filing shall include rates for 2005. Rates for 2006 and 2007 under Section 6 of Gas Accord III shall be submitted in PG&E’s Annual True-Up filings (see Section 8.4).

Service allocations, and illustrative rates, workpapers, and pro forma tariff changes necessary to implement the settlement.

3. The Settlement Parties request the Commission approve the pro forma tariff sheets at the same time it approves the Settlement Agreement, and that the tariffs and rates be effective on January 1, 2005.

4. The scoping memo, issued on May 27, 2004, determined that hearings were necessary, and set a procedural schedule. The Settlement Parties served testimony and rebuttal testimony while also participating in settlement discussions. A settlement in principle was reached on the eve of scheduled hearings.

5. The Gas Accord III resolves all contested issues in this proceeding and also supersedes and extinguishes the requirement in D.03-012-061 that PG&E file by February 2005 an application addressing gas market structure beginning in 2006.

6. The testimony served in this proceeding, entered into evidence for the sole purpose of evaluating the reasonableness of Gas Accord III, provides a comprehensive record for consideration of the settlement.

7. The Gas Accord III resolves all contested issues in this proceeding.

8. PG&E provided notice and an opportunity to participate in settlement discussions to all parties in A.01-10-011, the Commission's last gas market structure proceeding.

9. The Settlement Parties represent every affected segment of the natural gas industry, including core and noncore customers, wholesale customers, core aggregators, electric generators, producers and other suppliers of natural gas, and independent storage operators.

10. The tariff changes necessary to implement the Gas Accord III, as set forth in the pro forma tariff sheets, are reasonable.

11. The three-year term of the Gas Accord III has the advantage of providing rate certainty as well as a stable business environment for the natural gas industry in northern California over a protracted period.

12. Evidentiary hearings are not required.

Conclusions of Law

1. The scope of this proceeding is modified to consider the Gas Accord III.

2. The determination that hearings are necessary is changed.

3. The Commission reviews this uncontested settlement pursuant to Rule 51.1.(e) of the Commission's Rules of Practice and Procedure, which provides that the Commission must find a settlement reasonable in light of the whole record, consistent with the law, and in the public interest.

4. Adequate notice of the proposed settlement was provided to all parties in A.01-10-011 and the draft decision should be served on these same parties.

5. The written notice that PG&E has provided to its customers is sufficient notice for consideration of Gas Accord III.

6. The bill credit for Service to Moss Landing Units 1 and 2 in Section 3.3.1 is reasonable and consistent with past Commission practice.

7. We interpret the term "lateral pipeline" in Section 3.2.1.3 of the Gas Accord III to be equivalent to a service pipe or service lateral.

8. Should PG&E need to conduct an open season for storage during the Gas Accord III settlement period, it should file an advice letter requesting to hold an open season. This advice letter should provide the proposed terms and conditions for the bidding.

9. We interpret Section 1.2 is that Gas Accord III to extend the z factor adjustment, Catastrophic Events Memorandum Account (CEMA) and Hazardous Substance Mechanism (HSM), the Core Procurement Incentive

Mechanism (CPIM), the Risk Management Program and financial derivatives authorization provisions approved in D.03-12-061. Consistent with this, we find that under Gas Accord III the tariff provisions remain for the cash-out mechanism for imbalances, the local curtailment process and associated curtailment charges, and the customer self-balancing option.

10. The Gas Accord III is reasonable in light of the whole record, consistent with the law, and in the public interest.

11. This decision should be effective immediately so that the rates and tariff changes under the Gas Accord III can be effective January 1, 2005.

O R D E R

IT IS ORDERED that:

1. The Gas Accord III Settlement Agreement with its Appendices A and B, as filed on August 27, 2004 in the Joint Motion of Settlement Parties (Joint Motion), is approved and adopted.

2. The changes highlighted in the pro forma tariffs filed on August 27, 2004 in the Joint Motion are approved.

3. Pacific Gas and Electric Company shall file within 12 days of this decision a compliance filing containing the associated tariffs without modification to implement the rates and provisions of the Gas Accord III Settlement Agreement.

PG&E shall also include in this compliance filing an update Table 6-2 of its opening testimony to reflect the provisions of Gas Accord III and a completed page 24 to the Settlement workpapers.

4. The Commission's Process Office shall serve this decision on the service list in this proceeding, as well as on the service list for Application 01-10-011.

5. This is a final determination that evidentiary hearings are not required.

6. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.

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Subject to Rule 51 of the CPUC Rules of Practice and Procedure,
Rule 601 et seq. of the FERC Rules of Practice, Rule 408 of the Federal
Rules of Evidence, and Section 1152 of the California Evidence Code

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***Gas Accord III
Settlement Agreement***
August 27, 2004

1. Introduction

a. Purpose

The purpose of this Gas Accord III Settlement Agreement (“Settlement Agreement” or “Settlement”) is to resolve all the issues set for litigation in PG&E’s Gas Transmission and Storage 2005 Rate Case – Application 04-03-021. This Settlement is also in response to Ordering Paragraph 6j in Decision 03-12-061 that requires PG&E to file “an application no later than February 4, 2005 proposing the kind of gas market structure and rates that PG&E’s gas transmission and storage system should operate under [beginning in 2006] ... and how long the rates and such a structure should remain in place.”

b. Gas Accord

Under this Settlement Agreement, the basic Gas Accord structure approved in D.97-08-055 remains in place for Northern California. This includes unbundled transmission and storage services. Backbone transmission service is provided via defined paths under firm or as-available tariffs. Storage services are also offered on a firm and as-available basis. This Settlement Agreement makes certain small modifications to the existing Gas Accord provisions, as most recently modified in D.03-12-061, in addition to implementing a backbone level end-use service as ordered in D.03-12-061. As in the Gas Accord, the rates determined by this Settlement Agreement reflect a negotiated balance including, among other things, cost-of-service, backbone load factor, local transmission throughput, and annual cost of service escalators.

c. Settlement Parties

This Settlement Agreement is entered into by the Settlement Parties (“Settlement Parties” or “Parties”), as identified by their attached signatures. Parties agree to actively support approval of this Settlement Agreement in A.04-03-021. Parties also agree to not support any changes to this Settlement Agreement that would be effective during the term of this Settlement in any regulatory, legislative or judicial forum, other than as allowed under this Settlement Agreement.

d. Tariffs To Implement Settlement

Simultaneously with the filing of this Settlement Agreement, PG&E agrees to file for Commission approval pro forma tariff sheets that would implement the terms agreed to herein. Parties request that the Commission approve the pro forma tariff

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sheets at the same time it approves the Settlement Agreement, and that the tariffs and rates be effective on January 1, 2005.

e. Tariffs Not Affected

Unless otherwise explicitly changed by this Settlement Agreement, all other portions of PG&E's tariffs related to providing gas transmission and storage services remain in place through 2007 for transmission and through March 31, 2008 for storage, unless changed by other Commission action.

f. Compromise and Support

This Settlement Agreement is a negotiated compromise of issues and is broadly supported by parties who are gas producers, marketers, shippers, independent storage providers, wholesale and retail end-use customers, and regulatory representatives. Nothing contained herein shall be deemed to constitute an admission or an acceptance by any party of any fact, principle, or position contained herein. Notwithstanding the foregoing, the Settlement Parties, by signing this Settlement Agreement and by joining the motion to adopt the Settlement Agreement filed before the Commission, acknowledge that they pledge support for Commission approval and subsequent implementation of these provisions.

g. Complete Package

This Settlement Agreement is to be treated as a complete package not as a collection of separate agreements on discrete issues or proceedings. To accommodate the interests of different parties on diverse issues, the Settlement Parties acknowledge that changes, concessions, or compromises by a party or parties in one section of this Settlement Agreement necessitated changes, concessions, or compromises by other parties in other sections.

h. Modifications by Commission

In the event the Commission rejects or modifies this Settlement Agreement, the Settlement Parties reserve their rights under Rule 51.7 of the Commission's Rules of Practice and Procedure.

i. Implementation

Within 12 days of a Commission decision approving this Settlement Agreement and the associated tariffs without modification, PG&E shall make a compliance filing to implement the rates and provisions of the Settlement.

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2. Term of Settlement**a. Settlement Period**

The Settlement covers three rate-case years (Settlement Period). The Settlement Period is January 1, 2005 through December 31, 2007, for transmission services, and April 1, 2005 through March 31, 2008, for storage services.

b. Next Rate Case Filing

PG&E will file its next rate case no later than February 9, 2007.

Should rates not be in place for Gas Transmission and Storage (GT&S) services by January 1, 2008, pursuant to an order in this next rate case, the interim transmission and storage rates will equal the rates in effect on December 31, 2007, plus a two (2) percent escalator and other adjustments authorized by this Settlement. G-XF rates continue to be calculated based on Line 401 incremental costs. These interim rates will remain in effect until the Commission otherwise approves rates for the remainder of 2008.

c. Effective Date

The effective date of this Settlement Agreement shall be the later of January 1, 2005, or the effective date of the tariffs approved by the Commission to implement the Settlement.

3. Transmission Services**a. Backbone Services**

The path structure and backbone services remain the same. Except for the new backbone level end-use service, all gas transported using PG&E's backbone service must eventually be delivered to an on-system end user or wholesale customer using local transmission service, or to an off-system customer or delivery point.

Core Capacity Assignment and Vintage Capacity Allocation

PG&E's Core Procurement Department firm capacity assignments are as shown in Appendix A, Table A-1. Core Vintage Redwood firm capacity of 615.6 MDth/d (delivery capacity) is allocated to core retail and wholesale customers based on average-year January demands as shown in Appendix A, Table A-2.

Existing wholesale customers will have a one-time option prior to April 1, 2005, to subscribe to their allocation of Core Vintage Redwood firm capacity for the Settlement Period. This is the same one-time option previously available to wholesale customers under the Gas Accord.

During the Settlement Period, Core Procurement will meet and confer with ORA and TURN to discuss Core's firm storage and transportation needs.

Open Season

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PG&E will not hold an open season for existing firm backbone capacity at the beginning of the Settlement Period. Sufficient firm backbone capacity remains available for any customer desiring this service at this time.

Commensurate Discount Rule

The commensurate discount rule will be removed from PG&E's tariffs once PG&E is no longer affiliated with Gas Transmission Northwest (GTN), the former Pacific Gas Transmission Company (PGT).

Mission-Off As-Available Rate for Storage Withdrawals

PG&E will revise its Mission-Off as-available tariff (G-AAOff) to allow any storage withdrawals delivered into PG&E's backbone system to be nominated for off-system delivery at no additional charge. Priority of as-available service for off-system deliveries will continue to be based on price. The rate design for firm Mission-Off service does not change.

Backbone Firm Contract Conversion Option to Accommodate Storage Withdrawals

Shippers may convert all or part of a firm on-system Redwood path contract exhibit or firm on-system Baja path contract exhibit for the purpose of transporting gas withdrawn from storage to a firm on-system Mission path contract exhibit at any time prior to 60 minutes before close of the Timely Cycle. For those shippers that convert to a firm on-system Mission path contract exhibit, PG&E will reduce the MDQ by an equal amount on their corresponding firm on-system Redwood or firm on-system Baja path contract exhibit for the same time period. Shippers will not be charged additional shrinkage or a volumetric rate for Mission path service, but will be responsible for the full monthly demand charge on their firm on-system Redwood path or firm on-system Baja path contract exhibit regardless of the amount of time the contract exhibit is converted to a firm on-system Mission path contract exhibit. On-system Baja path conversions will be limited to the amount of unsold firm Redwood capacity available at the time of the requested conversion. Firm Baja path conversions may be requested on a monthly basis, no more than 5 days prior to the end of the month, for a maximum term of one month. There is no limit to the maximum term for a firm Redwood path conversion.

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b. Backbone Level End-Use Service

Backbone Level End-Use Service begins on the later of January 1, 2005, or the effective date of the tariff revisions required to implement this service. The eligibility criteria for this service are resolved for the term of this Settlement. Customers qualifying for this service do not pay the local transmission rate component as specified in the otherwise applicable end-use tariff. However, they continue to be responsible for all other rate components in their end-user tariffs to the extent they are not components of local transmission service, including, as applicable, the Customer Access Charge, Public Purpose Program Surcharge, Distribution Charge for G-EG Customers,¹⁶ CPUC fee, franchise fees and uncollectibles expense, G-SUR, Customer Class Charge, or other CPUC-mandated fees that may be implemented after this Settlement is finalized.

Backbone Level End-Use Service Eligibility Requirements

Backbone level end-use service eligibility is based on the criteria filed in PG&E's testimony in A.04-03-021.

The load must be new or incremental to PG&E's system (i.e., a new or repowered electric generation unit, a new process or production line, or other new gas-consuming equipment which is substantially stand-alone in nature) on or after March 1, 1998, and:

- a. Is by itself of sufficient size to qualify for noncore service; and
- b. Has separate PG&E metering, or other separate metering acceptable to PG&E.

The load must never have been physically connected to PG&E's local transmission or distribution system.

The lateral pipeline that delivers gas to the Customer's premise must be directly connected to PG&E's Backbone Transmission System, and must be either:

- a. 100 percent owned by, or fully under the operational control of, the end-use Customer or its affiliate, provided that:
 - i. The affiliate is wholly-owned and/or controlled by the Customer or a common parent of the Customer and the affiliate, and

¹⁶ These are the distribution costs allocated to distribution level electric generation customers taking service from G-EG. They will continue to be averaged in the rates of all end-use electric generation customers pursuant to Decision 03-12-061. The distribution rate is a separate rate component from the customer class charge. Parties are free to make proposals to de-average the distribution costs allocated to G-EG customers, in future proceedings such as BCAPs or GT&S Rate Case filings.

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- ii. The lateral is used exclusively by the Customer and/or its wholly-owned or commonly-controlled affiliates; or
- c. Owned by PG&E, but paid for in advance by the end-use Customer pursuant to:
 - i. An approved pro-forma agreement, such as Agreement to Perform Tariff Schedule Related Work (Form # 62-4527), Agreement for Installation or Allocation of Special Facilities (Form # 79-255), or Distribution and Service Extension Agreement, Cost Summary (Form # 79-1004), or
 - ii. A negotiated agreement under the exceptional case provisions under PG&E's gas Rules 15 or 16, which is subsequently approved by the CPUC.

Balancing Account for Changes to Customers Qualifying for Backbone Level End-Use Service

PG&E will track the change in local transmission demand arising from any changes to the customers that are identified as being eligible for backbone level end-use service as of the date of a Commission order approving this Settlement. PG&E will record the revenue debit or credit entry based on the customer's actual annual demand multiplied by the applicable local transmission rate in effect, for each customer identified as a change. The tracked amount will be allocated to the Core Fixed Cost Account and the Noncore Customer Class Charge Account in the same proportion as local transmission costs are allocated between core and noncore customers, respectively, and will be reflected in rates in the Annual True-Up of Balancing Account filings (Annual True-Up). This treatment does not apply to new customers.

c. Local Transmission Service

Local transmission service remains the same. Except for customers qualifying for backbone level end-use service, this service continues to be non-bypassable for all on-system end-use and wholesale customers taking local transmission service from PG&E.

Bill Credit for Service to Moss Landing Units 1 and 2

A credit of \$166,667 per month will be applied to the bill for local transmission service to Moss Landing Power Plant Units 1 and 2, effective with the implementation of the local transmission rates adopted for the Settlement Period. This \$2 million per year will be collected through PG&E's backbone rates as a volumetric surcharge.

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d. PG&E Authority to Negotiate Rate Discounts

Nothing in this Settlement alters PG&E's existing authority to negotiate rate discounts for backbone transmission service or for bundled end-use services. PG&E is willing to negotiate discounts to these services with customers that have competitive alternatives or under other circumstances that PG&E determines justify such discounts.

Also, nothing in this Settlement Agreement shall modify existing negotiated agreements between PG&E and any end-use customer or other shipper.

4. Storage Services

Storage services remain the same. Assignments of firm storage to PG&E's Core Procurement Department, pipeline balancing, and noncore storage service as approved in D.03-12-061 do not change during the Settlement Period, unless required by Commission order in R.04-01-025 or other regulatory proceeding. This includes the additional firm storage assigned to pipeline balancing in D.03-12-061.

a. Open Season

PG&E will not hold an open season for existing firm storage capacity at the beginning of the Settlement Period. Sufficient firm storage capacity remains available for any customer desiring this service.

b. Sale of Noncycle Working Gas

PG&E retains the right during the Settlement Period to file a Section 851 application to sell noncycle working gas in order to expand its annual ability to cycle storage on behalf of its storage customers.

c. Updated Report on Added Storage for Pipeline Balancing

When PG&E files its next rate case as provided in Section 2.2.1, PG&E will provide a full update to the "Report on Additional Storage Capacity for Pipeline Balancing Service" it filed on June 30, 2004, in A.04-03-021.

5. Cost of Service**a. Comparison to Filed Case**

Appendix A, Table A-3 shows the adjustments from PG&E's filed cost of service, as updated in its June 11, 2004 Supplemental Filing. Appendix A, Table A-4 shows the cost of capital underlying this cost of service. As provided in Section 8.2, the cost of service and rates will be adjusted to reflect a Commission decision in PG&E's recently filed cost of capital case, A.04-05-023.

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b. Allocation of Expenses

Under the Gas Accord, operating expenses were allocated to Unbundled Cost Categories (UCCs) primarily based on plant. Since then, more detailed data is available on operation and maintenance (O&M) expense incurrence by UCC. Consistent with other rate case approaches, this direct assignment method is to be used for allocating O&M expenses beginning January 1, 2006. For 2005, the allocation is based on half the O&M costs allocated using the direct assignment method and half using the plant method. Administrative and General (A&G) allocation to UCCs follows the O&M labor.

c. Revenue Requirement

The Gas Transmission and Storage revenue requirement over the Settlement Period is shown in the table below. The total revenue requirement escalates at two (2) percent for 2006 and 2007, except for the revenue requirement attributable to the G-XF contracts.

	2005	2006	2007
Backbone, without balancing	\$210.3	\$226.6	\$231.2
G-XF Contracts	8.2	7.9	7.6
Local Transmission	146.1	135.9	138.6
Storage, including load balancing and non-base carrying costs	58.9	61.1	62.3
Net Revenue Requirement	\$423.5	\$431.5	\$439.7
Customer Access Charge	5.0	5.1	5.2
Total Revenue Requirement	\$428.5	\$436.6	\$444.9

6. Cost Allocation and Rates

Illustrative 2005 class average rates are shown in Appendix B, Tables 1 and 2. For noncore retail and wholesale customers, the rates reflect the impacts of the 2005 local transmission and customer access charges agreed to in this Settlement. For bundled core customers, the rates reflect the impacts of the 2005 local transmission, storage and intrastate backbone charges agreed to in this Settlement. For core transport customers, the rates reflect the impacts of the 2005 local transmission rates agreed to in this Settlement.

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All rate changes will be effective January 1 of each year, including storage rates.

a. Backbone Load Factor, Cost Allocation and Rates

The backbone load factors used to determine firm backbone rates are:

2005 74.0 percent

2006 75.0 percent

2007 76.5 percent

These are negotiated numbers, and Settlement Parties do not take any position with respect to the underlying demand and throughput adjustments.

Core Vintage rate design for reserved Line 400 firm capacity is retained for the Settlement Period.

The backbone cost of service by UCC is allocated to paths based on firm capacities shown in Appendix A, Table A-5. This cost allocation methodology remains constant over the Settlement Period. The backbone cost allocation by path is shown in Appendix A, Table A-6.

Backbone rate design remains the same, except as set forth in Section 3.1.4, above. All path rates are based on the allocated costs and the backbone load factors specified in Section 6.1.1 above. G-XF rates continue to be calculated using incremental Line 401 costs.

Appendix B, Tables 3 through 9, show the backbone rates by service and rate design.

b. Storage Cost Allocation and Rates

Storage cost allocation and rate design methods remain the same. Appendix A, Tables A-7 and A-8 show the firm capacities used to allocate costs and the resulting cost allocation to Injection, Inventory and Withdrawal. Storage rates are shown in Appendix B, Table 10.

c. Local Transmission Throughput, Cost Allocation and Rates

The local transmission throughput is shown in Appendix A, Table A-9. The 2005 throughput increases at two (2) percent for 2006 and 2007 for purposes of calculating local transmission rates.

Local Transmission cost of service continues to be allocated to core and noncore customer classes based on Cold-Year January (CYJ) demand. This cost allocation is shown in Appendix A, Table A-10.

Local transmission rates continue to be designed on a postage stamp basis.

The core local transmission revenue requirement will receive full balancing account protection through monthly entries to the Core Fixed Cost Account (CFCA). This will reduce the year-to-year variability of this cost component.

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Local Transmission rates are shown in Appendix B, Table 11.

d. Customer Access Charge

There are no changes to the current 2004 Customer Access Charges (CACs) rate structure. CACs applicable to industrial and electric generation customers are based on a six-tier fixed monthly charge rate design. The two-part fixed and volumetric Tier 6 CAC in PG&E's filed case has been eliminated. The CACs applicable to wholesale customers continue to be based on customer-specific CAC cost of service. These charges are shown in Appendix B, Table 12.

e. Self-Balancing Credit

If a customer elects to self-balance pursuant to Rate Schedule G-BAL, they receive a credit as shown in Appendix B, Table 13.

7. PG&E Core Procurement and Core Transportation Agents**a. Additional Core Storage Services**

The Draft Decision of ALJ Fukutome and ALJ Wong, dated July 20, 2004, in Rulemaking 04-01-025 orders PG&E to file an application within six (6) months "to address how much, and by what process, incremental gas storage needs for the core should be put out to bid as well as other implementation issues that PG&E feels need to be address before the provisioning of core storage is opened to independent storage providers." PG&E's current Core Firm Storage assignment is outlined in Table A-7 of this settlement.

The Parties agree not to advocate modifications of the portion of the Draft Decision that would order incremental core storage service to be opened to independent storage providers. If this issue is not addressed in the Phase I decision expected to issue in R.04-01-025, PG&E agrees that within two months of Commission approval of this settlement, but not before February 2005, PG&E will file such an application addressing the same topics as specified in the Draft Decision. Regardless of whether this filing is made pursuant to this settlement or a Commission order in R.04-01-025, prior to filing the application, PG&E agrees to meet with ORA, TURN, third-party storage providers and other parties to discuss, and attempt to reach a consensus on the contents of such a filing regarding the manner in which a competitive bidding process for the incremental storage capacity needs of the core will be implemented.

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b. GTN, TCBC and NGTL Capacity (Northern Interstate Path)

CTAs will have an annual option to accept a proportional share of firm capacity contracted for and held by PG&E for its core customers on Gas Transmission Northwest (GTN), TransCanada PipeLines B.C. System (TCBC, formerly ANG) and NOVA Gas Transmission Ltd. (NGTL, formerly NOVA) – the Northern Interstate Path. The amount of Northern Interstate Path capacity made available to the CTA will be the Group's January capacity factor times the firm interstate capacity reserved for PG&E's core customers. A CTA may elect to take all or part of their allocation provided the same percentage share is taken on all three pipelines. PG&E will provide this option annually on or before the 1st of September, and CTAs must respond with their election on or before September 30. Capacity will then be awarded for the one-year contract period starting November 1 each year.

Until CTA market share exceeds 5% of the core load, no adjustments will be made for an increase or decrease in aggregator load until the next annual assignment period. Once CTA market share exceeds 5% of core load, PG&E will propose an adjustment mechanism in the next available proceeding. CTAs may broker this assignment of capacity up to the end of the assignment period. New CTAs will wait until the next annual assignment period to receive a Northern Interstate Path assignment. All Northern Pipeline Path capacities that are not accepted for assignment by CTAs are assigned to PG&E's Core Procurement Group. Also, if a CTA terminates service and has not brokered its Northern Interstate Path assignment, the capacity will revert back to PG&E's Core Procurement Group.

This provision will be effective on November 1, 2005, and will extend through October 31, 2008. The current GTN and Firm Canadian Capacity provisions in schedule G-CT will be replaced. When and if the annual CTA load reaches 10% of the annual aggregate core load, all CTA pipeline allocations will be capped at 10% until the Commission reviews and approves a new process for future CTA pipeline allocations.

This section only applies to the Northern Interstate Path and not any other Core Procurement firm pipeline holdings.

c. Core Procurement Brokerage Fee

The Core Brokerage Fee is increased to \$0.030 per Dth to reflect inflation since 1997. This change occurs as of the effective date of tariffs implementing this Settlement.

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August 27, 2004

d. CTA Firm Winter Capacity Requirement

PG&E will modify the Firm Intrastate Pipeline Capacity Alternate Resource exemption provision in Schedule G-CT to exclude "High Inventory OFOs" when evaluating the exemption compliance provisions. Only Low Inventory OFOs would be counted when evaluating exemption compliance. Schedule G-CT would then read *"If a CTA has fulfilled this Firm Winter Capacity Requirement and has incurred no instances of non-compliance with an Emergency Flow Order (EFO) and no more than one (1) such instance with a **Low Inventory** Operational Flow Order (OFO) as specified in Rule 14 for a two year period, the CTA will no longer be required to meet this Firm Winter Capacity Requirement."*

8. Rate Certainty and Adjustments During Term of Settlement**a. Rate Certainty**

The rates specified in this Settlement Agreement are not subject to adjustment during the Settlement Period except as provided herein, or as agreed to by the Settlement Parties and approved by the Commission.

Nothing in this Settlement Agreement shall prevent PG&E from making adjustments to services, capacity assignments, cost allocations, rates or the like in order to comply with Commission orders in other proceedings. No Settlement Party shall make any proposal that would conflict with or alter any term of this Settlement Agreement, and the Settlement Parties shall not support proposals of others that would do the same.

b. Cost of Capital Adjustment

The cost of capital used to set rates for the Settlement Period will be the cost of capital for 2005 adopted by the Commission in A.04-05-023. Should this decision be delayed beyond January 1, 2005, the filed Settlement rates will apply for 2005, and the adjustment to 2005 revenues resulting from the cost of capital decision will be reflected in core and noncore customer rates in the next Annual True-Up filing consistent with the method approved in Advice 2521-G for recovery of Administrative and General expenses adopted in 2003 GRC D.04-05-055. For 2006 and 2007, rates will be adjusted prospectively for the effects of the 2005 cost of capital decision.

c. Line 57C Project

Rates may be adjusted during the Settlement Period to include the costs for the Line 57C Project, if approved by the Commission in a separate application, and if the project is placed in service during the Settlement Period.

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d. Annual True-Up and BCAP Filings

Certain rates, such as the Distribution and Customer Class charge, will continue to change with PG&E's BCAP or Annual True-Up filings, and as a result of other Commission decisions. This Settlement Agreement does not change these existing procedures and filings.

e. Operational Provisions

During the term of the Settlement Agreement, operational issues may arise that need to be addressed. This Settlement Agreement does not preclude the ability of PG&E or any other party to bring operational issues and solutions to the Commission for its review and approval, or of any Settlement Party to respond as it deems appropriate should any operational issues and solutions be submitted to the Commission.

***Gas Accord III
Settlement Agreement***

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APPENDIX A

Tables Supporting the Settlement

Gas Accord III Settlement Agreement
Appendix A

Table A-1
Backbone Capacity Assignments to Core Customers, MDth/d

Line No.		Summer	Fall/Spring	Winter
1	Redwood	608.766	608.766	608.766
2	Baja	155.000	310.000	669.000
3	Silverado	<u>5.000</u>	<u>5.000</u>	<u>5.000</u>
4	Total	768.766	923.766	1,282.766

Table A-2
Vintage Redwood Capacity Assignments to Core Retail and Core Wholesale Customers, MDth/d

Line No.	Customer	Vintage Redwood Assignment
1	Retail Core	608.766
2	Wholesale Core	
3	Alpine	0.098
4	Coalinga	0.552
5	Island Energy	0.064
6	Palo Alto	5.898
7	WCG – Castle	0.051
8	WCG – Mather	<u>0.171</u>
9	Subtotal Wholesale	<u>6.834</u>
10	Total	615.600

Gas Accord III Settlement Agreement
Appendix A (continued)

Table A-3
2005 Cost of Service Adjustments From Filed Case, \$ Thousands

Line No.		
1	Filed 2005 COS	\$433,887
2	A&G from GRC	<u>(4,900)</u>
3	Subtotal	\$428,987
4	Adjustments:	
5	SMUD O&M Credit	(1,079)
6	SEGDA Credit	(823)
7	O&M / Capital Adjustment	(2,085)
8	Pipeline Balancing Adjustment	<u>1,000</u>
9	Adjusted 2005 COS	\$426,000
10	Storage Carrying Costs (non-base revenue)	<u>2,519</u>
11	Revenue Requirement	\$428,519

Table A-4
Cost of Capital Underlying Filed Cost of Service

	<u>Share</u>	<u>Cost</u>	<u>Weighted</u>
Debt	47.2%	6.70%	3.16%
Preferred Equity	2.3%	6.07%	0.14%
Common Equity	<u>50.5%</u>	<u>11.22%</u>	<u>5.67%</u>
Total	100.0%		8.97%

Gas Accord III Settlement Agreement
Appendix A (continued)

Table A-5
2005 Firm Capacity for Cost Allocation to UCC, MDth/d

Line No.	Rate Path	Line 400/ Line 2	Line 401	Redwood Expansion	Line 300	Gathering*	Other Backbone
1	On-System Backbone						
2	Redwood Vintage	615.6					615.
3	Redwood	377.2	681.9	218.4	—	—	1,277.5
4	Baja	—	—		1,102.4		1,102.4
5	Silverado	—	—		—	155.4	155.
6	Mission	—	—		—		—
7	Subtotal	992.8	681.9	218.4	1,102.4	155.4	3,150.9
8	G-XF Contracts		91.8		—	—	—
9	Total	992.8	773.7	218.4	1,102.4	155.4	3,150.9

* Calculated as 115 MDth per day divided by the backbone load factor.

Table A-6
Costs by Backbone Path* for 2005, 2006 and 2007, \$ Million

Line No.	Backbone Path*	2005	2006	2007
1	Redwood Path – Core	\$ 26.3	\$ 29.1	\$ 29.7
2	Redwood Path	105.1	108.6	110.8
3	Line 401 Incremental G-XF	8.2	7.9	7.5
4	Subtotal Redwood	\$139.6	\$145.6	\$148.0
5	Baja	81.6	91.6	93.5
6	Silverado	7.3	7.7	7.8
7	Total	\$228.5	\$244.9	\$249.3

* Includes Storage Load Balancing from Table A-8.

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Appendix A (continued)

Table A-7
Firm Capacity for Storage Cost Allocation to Services

Line No.	Storage Service	Annual Average Injection MDth/d	Inventory MMDth	Annual Average Withdrawal MDth/d
1	Firm Storage Services			
2	Core Firm Storage	112.533	33.478	489.318
3	Standard Firm Storage	16.524	4.783	93.932
4	Monthly Balancing Service	76.125	4.100	76.125
5	Total	205.181	42.360	659.375

Table A-8
Storage Cost Allocation to Services for 2005, 2006 and 2007, \$ Million

Line No.	Storage Service	2005	2006	2007
1	Firm Storage Services			
2	Core Firm Storage	\$41.6	\$43.1	\$44.0
3	Standard Firm Storage	7.3	7.6	7.8
4	Monthly Balancing Service*	10.0	10.3	10.6
5	Total	\$58.9	\$61.0	\$62.3

* Included in Backbone Transmission Costs in Table A-6.

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Appendix A (continued)

Table A-9
Local Transmission Throughput For 2005, 2006 and 2007, MDth/d

Line No.		
1	Core	820.9
2	Noncore Non-EG	415.3
3	Electric Generation and Cogeneration	628.8
4	Wholesale	<u>10.5</u>
5	Total End-Use	1,875.5
6	Backbone End-Use	(185.7)
7	G-10 and EAD Discount Adjustments	<u>(58.5)</u>
8	2005 LT Throughput	1,631.3
9	2006 LT Throughput (2% growth)	1,664.0
10	2007 LT Throughput (2% growth)	1,697.2

Table A-10
Local Transmission Cost Allocation To Customer Classes
for 2005, 2006 and 2007

Line No.	Local Transmission	2005	2006	2007
1	Core CYJ Demand, Mth	570,184	570,184	570,184
2	Percentage	70.03%	70.03%	70.03%
3	Noncore CYJ Demand on LT, Mth	243,982	243,982	243,982
4	Percentage	<u>29.97%</u>	<u>29.97%</u>	<u>29.97%</u>
5	Total CYJ on LT, Mth	<u>814,166</u>	<u>814,166</u>	<u>814,166</u>
6	Core, \$ Million	\$102.3	\$ 95.2	\$ 97.1
7	Noncore, \$ Million	<u>43.8</u>	<u>40.7</u>	<u>41.5</u>

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Line No.	Local Transmission	2005	2006	2007
8	Total, \$ Million	\$146.1	\$135.9	\$138.6

***Gas Accord III
Settlement Agreement***
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APPENDIX B
Detailed Rate Tables